



The Pakistan Credit Rating Agency Limited

Rating Report

Mirpurkhas Sugar Mills Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Jun-2019	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The sugar industry of Pakistan has been under pressure in recent times. A distortion in the support price mechanism for sugarcane in conjunction with a persistent supply glut has negatively impacted players across the industry. Slowdown in international sugar prices has rendered domestically manufactured sugar uncompetitive, making exports viable only through subsidy support. However, prices have improved in the domestic market and the government, especially provincial governments, have paid the subsidy amount. These factors have eased the liquidity pressure to an extent and have also improved overall profitability.

The ratings reflect the Company's established position in Pakistan's sugar industry and its association with a leading industrial group – Ghulam Faruque Group. Experienced and qualified management staff add value to the Company's business profile. As made necessary owing to the volatile nature of the sugar industry, the Company's profitability is supported through inflows emanating from strategic investments in associates, including diversification in Unicol, a leading ethanol producer. Nonetheless, dependence on investment income remains high. Business fundamentals are challenged as high concentration of mills in close vicinity forces the Company to procure raw materials from outside its area, incurring high transport costs. However, going forward, recovery in domestic sugar prices and high stocks available will enhance the Company's profitability. Meanwhile, the Company's financial profile is stretched and is characterized by weak coverages, extended working capital and an aggressive capital structure.

Ratings are dependent on the Company's ability to improve profitability while strengthening coverage ratios. Prudent management of debt structure and efficient working capital management to eliminate any mismatch is critical for ratings. Any significant deterioration in business performance and/or financial health will negatively impact ratings.

Disclosure

Name of Rated Entity	Mirpurkhas Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Sugar(Apr-19)
Rating Analysts	Silwat Malik silwat.malik@pacra.com +92-42-35869504

Profile

Legal Structure Mirpurkhas Sugar Mills Limited (the Company) is a public limited company, listed on the Pakistan Stock Exchange.

Background The Company was incorporated in 1964 and commenced operations two years later in 1966 with a crushing capacity of 1,500 TCD. Over the years, through frequent BMR activities and capacity enhancements, crushing capacity for the Company now stands at 12,500 TCD.

Operations Primary business activity of the Company involves the manufacture and sale of sugar. The Company's mill is located at Umerkot Road in Mirpurkhas, Sindh. Meanwhile the head office is based in Karachi. During the current crushing period (MY19), the Company crushed a total of 577,396 MT of sugarcane while achieving a recovery rate of 11.25% and producing 64,935 MT of sugar.

Ownership

Ownership Structure Major shareholding of the Company lies with the Faruque Family and its associate companies, with ~57% shareholding. The Family controls ~41% of the Company through its holding company, Faruque (Private) Limited followed by associated companies (~10%) and individuals (~7%). Remaining shareholding is attributable to the general public (~23%), NIT (~9%), Public Sector Corporations (~6%), Banks and DFIs (~1%) and Others (~3%).

Stability The Company is currently being run by the third generation of sponsors, with the fourth generation gradually being inducted in the business. The existence of a holding company structure with defined interests of each family and understanding among sponsoring family members reflects stability in ownership.

Business Acumen The Company is a part of the Ghulam Faruque Group which was incorporated in 1964 by Mr. Ghulam Faruque. In addition to sugar, the Group has established a strong presence in the country's cement and packaging industry. Moreover, the Group is involved in air conditioning, power and software solutions, though development of operations is still required.

Financial Strength The Company derives financial strength thorough the support of its Group which houses well-known companies under its umbrella, such as, Cherat Cement Company Limited and Cherat Packaging Limited. During FY18, total revenue for the Group stood at ~PKR 29bln.

Governance

Board Structure Board of Directors comprises eight members, including the Chairman, four non-executive directors, two executive directors and two independent directors, one of whom is a representative of NIT.

Members' Profile Members have diversified backgrounds with noteworthy experience and specialize in sugar, cement, packaging and finance.

Board Effectiveness Board of Directors maintain effective oversight through the formation of an Audit Committee and Human Resources and Remuneration Committee. High frequency and participation among board members bodes well for the Company.

Financial Transparency Kreston Hyder Bhimji & Co. Chartered Accountants, have expressed an unqualified opinion on the financial reports for the Company for the year ending in September, 2018. The firm is classified under category 'A' by the State Bank of Pakistan and possesses a satisfactory QCR rating.

Management

Organizational Structure The Company's organizational structure is based on ten departments, including finance, sales and marketing, procurement and internal audit, among others. All department heads report to the Chief Operating Officer, who holds dual positions of Chief Financial Officer as well. Subsequently, the highest level of authority lies with the Chief Executive Officer.

Management Team Management comprises of experienced individuals, representing a good skill mix. Mr. Aslam Faruque, Chief Executive Officer, holds over 24 years of overall experience. He also serves as the Chief Executive Officer of Unicol Limited, a joint venture distillery project of the Company.

Effectiveness The Company monitors operational efficiency and effectiveness of management systems through two management committees, namely, technical committee and IT steering committee. Meetings are conducted at regular intervals with high frequency during the crushing period.

MIS Implemented in 2010, the Company deploys SAP as its Enterprise Resourcing and Planning system. Moreover, various production and sales reports are submitted to senior management for evaluation.

Control Environment In order to ensure operational efficiency, the Company has setup an internal audit function. The department conducts regular reviews to monitor effectiveness of operations while identifying potential areas of improvement.

Business Risk

Industry Dynamics Pakistan is the 5th largest country in the world in terms of area under sugarcane cultivation, 7th by production and 53rd by yield. The sugar industry in Pakistan is the 2nd largest agro based industry comprising ~90 sugar mills with annual crushing capacity estimated between 65 – 70 million tons. During FY18, sugar production totaled to ~6.6mln Mt, coming down from ~7mln Mt in the preceding year.

Relative Position Owing to the high number of players in the industry, companies relatively have low market share. During MY18, the Company had a 1.34% share in total sugar production of the Country.

Revenues During MY18, revenue increased by ~49% on the back of higher production and pile up of carry over stock which was accumulated due to low sales in the preceding year. The Company engaged heavily in exports which comprised 68% of total revenue. During MY18, the Company exported 74,021Mt of sugar as compared to 22,123Mt in the preceding year. Higher exports are attributable to announcement of subsidy, both, by the provincial and federal government. However, the Company was affected by low international prices owing to a glut in the international market. During 1HMY19, revenue clocked in at ~PKR 1,120mln, ~70% lower than what was achieved in the corresponding period. A decline in sales can be traced to lower production, absence of exports and anticipation of favorable prices.

Margins Business performance improved during MY18 on the back of subsidies worth PKR 20/kg offered by the provincial and federal government. The Company was able to improve gross margin to ~9% during MY18, though it still remained low as compared to peers (MY17: ~2%). Low gross margin is a factor of high transport costs incurred by the Company owing to high consolidation of mills in the vicinity. High operating costs, attributable to a surge in freight and handling costs, resulted in an operating loss of PKR 700,000 during MY18 (MY17: PKR ~215 mln). Support from dividend income and share of profit from investments helped the Company post a net profit margin of ~2% after posting a ratio of negative ~10% in the preceding year. During 1HMY19, gross margin improved to ~10% as compared to 8% in the corresponding period. Similarly, high income from investments helped net profit reach to ~PKR 76mln during 1HMY19 (1HMY18: ~PKR 56mln).

Sustainability Going forward, the Company plans on diversifying its business profile by setting up a paper mill with a production capacity of 36,000 – 42,000 Mt. The project is expected to have a cost of ~PKR 1.7bln and is currently undergoing market research.

Financial Risk

Working Capital The Company's working capital requirements are a function of its inventories. An inherent stress is faced by the Company owing to seasonality in the crushing cycle. Working capital requirements are met through a mix of internal cash generation and short-term borrowings. Working capital requirements have remained high as the Company held on to inventory during adverse market dynamics. As a result the Company witnessed high net working capital days and excess short-term borrowings. Net working capital days during MY18 stood at 134 days (MY17: 138 days). Additionally, a persistent mismatch in the Company's debt mix was observed. During 1HMY19, net working capital days remained elevated at 274 owing to high stocks accumulated as the Company concluded sugarcane crushing. However, impact was subdued as payments to suppliers were extended. Nonetheless, continued mismatch in the Company's debt mix reflects negatively on the Company.

Coverages Owing to depressed business performance caused by adverse market conditions, the Company's cashflows have remained under stress. After posting a negative FCFO of ~PKR 33mln in MY17, the Company was able to improve the figure to PKR 188mln on the back of improved profitability in MY18. However, substantial finance costs resulted in an interest coverage of only 0.9x in MY18, reflecting the Company's weak ability to meet financial obligations. Coverages remained under pressure during 1HFY19 with interest coverage standing at 0.2x and total coverage at 0.4x.

Capitalization The Company has an aggressive capital structure with a debt-to-equity ratio of 68% during 1HMY19. Total debt is inclined towards short-term borrowings which make up ~85% of the capital structure. Total debt in 1HMY19 increased by 48% as compared to MY18, mainly owing to high short-term borrowings. High borrowings are attributable to high working capital requirements during the crushing period.

Mirpurkhas Sugar Mills Limited
Private Limited

1 BALANCE SHEET	Mar-19 6M	Sep-18 12M	Sep-17 12M	Sep-16 12M
a Non-Current Assets	2,467	2,424	2,376	2,040
b Investments (Incl. Associates)	1,765	1,795	1,859	2,058
Equity Instruments	1,765	1,795	1,859	2,058
Debt Instruments	-	-	-	-
c Current Assets	4,188	2,287	3,146	1,165
Inventory	2,886	1,074	2,030	219
Trade Receivables	63	38	104	59
Others	1,239	1,174	1,012	887
d Total Assets	8,420	6,505	7,381	5,262
e Debt/Borrowings	4,634	3,132	3,868	1,364
Short-Term	3,759	2,160	2,739	724
Long-Term (Incl. Current Maturity of Long-Term Debt)	875	973	1,129	640
Other Short-Term Liabilities	1,040	559	601	692
Other Long-Term Liabilities	556	564	404	266
f Shareholder's Equity	2,190	2,250	2,508	2,941
g Total Liabilities & Equity	8,420	6,505	7,381	5,262
2 INCOME STATEMENT				
a Turnover	1,120	4,170	2,802	3,763
b Gross Profit	110	382	(47)	328
c Net Other Income	238	320	150	150
d Financial Charges	(171)	(210)	(229)	(133)
e Net Income	76	73	(270)	150
3 CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	32	188	(33)	174
b Total Cashflows (TCF)	193	452	(1)	232
c Net Cash changes in Working Capital	(1,424)	653	(2,082)	202
d Net Cash from Operating Activities	(1,375)	893	(2,277)	300
e Net Cash from Investing Activities	(86)	(162)	(166)	(439)
f Net Cash from Financing Activities	1,484	(735)	2,445	104
g Net Cash generated during the period	23	(4)	2	(35)
4 RATIO ANALYSIS				
a Performance				
Turnover Growth	-70%	49%	-26%	23%
Gross Margin	10%	9%	-2%	9%
Net Margin	7%	2%	-10%	4%
ROE	7%	3%	-10%	5%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.1	0.3	-0.1	0.4
Interest Coverage (X) (FCFO/Gross Interest)	0.2	0.9	-0.1	1.3
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	-5.1	-64.8	-4.9	20.0
c Working Capital Management				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	274	134	138	43
d Capital Structure (Total Debt/Total Debt+Equity)	68%	58%	61%	32%

Mirpurkhas Sugar Mills Limited
Jun-19

Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
AA+ AA AA-	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	A1	A strong capacity for timely repayment.
A+ A A-	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
BBB+ BBB BBB-	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
BB+ BB BB-	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
B+ B B-	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.	C	An inadequate capacity to ensure timely repayment.
CCC CC C	Very high credit risk. Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.		
D	Obligations are currently in default.		



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) Conflict of Interest

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

- (3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(F-VII)

Proprietary Information

(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent